

United States Courts
Southern District of Texas
FILED

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

JUN 10 2002

Michael N. Milby, Clerk of Court

In re ENRON CORPORATION SECURITIES	§	Civil Action No. H-01-3624
LITIGATION	§	(Consolidated)
<u>This Document Relates To.</u>	§	
	§	<u>CLASS ACTION</u>
MARK NEWBY, et al., Individually and On	§	
Behalf of All Others Similarly Situated,	§	
	§	AMICUS CURIAE MEMORANDUM
Plaintiffs,	§	RELATING TO DEFENDANTS'
	§	MOTIONS TO DISMISS FILED BY THE
vs.	§	ATTORNEYS GENERAL OF ARKANSAS,
	§	CALIFORNIA, CONNECTICUT,
ENRON CORP., et al.,	§	GEORGIA, ILLINOIS, LOUISIANA,
	§	MASSACHUSETTS, MONTANA,
Defendants.	§	NEBRASKA, NEW JERSEY, NEW
THE REGENTS OF THE UNIVERSITY OF	§	MEXICO, NEW YORK, OHIO, OREGON,
CALIFORNIA, et al., Individually and On	§	PENNSYLVANIA, TENNESSEE, TEXAS,
Behalf of All Others Similarly Situated,	§	WASHINGTON, WEST VIRGINIA, and
	§	WISCONSIN
Plaintiffs,	§	
	§	
vs	§	
	§	
KENNETH L. LAY, et al.,	§	
	§	
Defendants.	§	

**AMICUS CURIAE MEMORANDUM OF THE STATE ATTORNEYS GENERAL
RELATING TO DEFENDANTS' MOTIONS TO DISMISS**

This memorandum is submitted on behalf of the States of ARKANSAS, CALIFORNIA, CONNECTICUT, GEORGIA, ILLINOIS, LOUISIANA, MASSACHUSETTS, MONTANA, NEBRASKA, NEW JERSEY, NEW MEXICO, NEW YORK, OHIO, OREGON, PENNSYLVANIA, TENNESSEE, TEXAS, WASHINGTON, WEST VIRGINIA, and WISCONSIN, by their Attorneys General (the "State Attorneys General") to address the proper

861

interpretation of the United States Supreme Court decision, *Central Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164 (1994). For the reasons set forth below, this court's application of federal securities law to the pending Defendants' Motions to Dismiss, stands to affect all citizens of the States, not just those who are putative class members in this litigation.

I. INTEREST OF THE STATES

In 1998, Congress enacted the Securities Litigation Uniform Standards Act, Pub. L. No. 105-353 ("SLUSA"). With very limited exceptions, this preemption legislation eliminated the ability of defrauded investors to seek recovery for their losses through class actions under state or common law. The states have a strong interest in the proper determination of the remedies available for securities fraud subsequent to the passage of SLUSA to insure protection of their citizens from securities fraud by holding perpetrators of fraud accountable and deterring future fraudulent conduct, while at the same time limiting federal remedies to their proper ambit.¹

The anti-fraud provisions of many States' securities statutes are patterned after the federal securities laws. Therefore, state courts often look to federal case law for interpretive guidance in construing state securities statutes. A decision as to the scope of the federal anti-fraud provisions could affect both civil remedies available to investors and states' ability to hold actors criminally responsible.

In this case, plaintiffs have alleged that the bank, law firm and accountant Defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated by the Securities

¹ The states and in particular, state pension funds, were expressly exempted from SLUSA preemption provisions, and could pursue independent causes of action in state courts. Nevertheless, the states are keenly interested in the correct application of federal securities laws, and offer this amicus brief in the public interest rather than on behalf of the state pension funds, which are putative class members.

and Exchange Commission thereunder. Those persons who violate Rule 10b-5, not merely aid and abet in a violation, should be held liable for securities fraud, regardless of their professional status. The States believe that the detailed allegations of the Consolidated Complaint are sufficient to sustain a cause of action under § 10(h) and Rule 10b-5 against the bank, law firm, and accountant Defendants under applicable federal law

II. ALL OF THE BANK, LAW FIRM, AND ACCOUNTANT DEFENDANTS ARE SUBJECT TO LIABILITY UNDER § 10(b) AND RULE 10b-5 FOR DIRECTLY PARTICIPATING IN THE ENRON SECURITIES FRAUD

A. The Banks, Law Firms, and Accountants are Subject to Broad Liability for Manipulative and Deceptive Devices and Contrivances Under § 10(b) and Rule 10b-5

The language of the principal anti-fraud provision of the federal securities laws, the starting place for any issue of statutory construction concerning these laws, is extremely broad. Section 10(b) of the Securities Exchange Act of 1934 prohibits “any person” from “directly or indirectly” using or employing “any manipulative or deceptive device or contrivance” in connection with the purchase or sale of a security. 15 U.S.C. §78(j)(b). Thus, the federal securities laws hold any person subject to liability for any manipulative or deceptive device or contrivance; the language does not make any distinctions based on title, profession, or industry and does not immunize any category of persons or entities.

Section 10(b) grants explicit authority to the Securities and Exchange Commission to define “manipulative or deceptive devices or contrivances” through “such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.” *Id.* The SEC exercised this authority in 1942 by adopting Rule 10b-5 to specify three overlapping yet distinct categories of manipulative or deceptive devices or contrivances:

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(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

17 C.F.R. §240.10b-5 (emphasis added).

Thus, under Rule 10b-5, the Defendants may be held liable for any of the following:

1. Employing a device to defraud (Rule 10b-5(a));
2. Employing a scheme to defraud (Rule 10b-5(a));
3. Employing an artifice to defraud (Rule 10b-5(a));
4. Making any untrue statement of a material fact (Rule 10b-5(b));
5. Omitting to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading (Rule 10b-5(b));
6. Engaging in an act which operates or would operate as a fraud or deceit upon anyone (Rule 10b-5(c));
7. Engaging in a practice which operates or would operate as a fraud or deceit upon anyone (Rule 10b-5(c)); or
8. Engaging in a course of business which operates or would operate as a fraud or deceit upon anyone (Rule 10b-5(c)).²

Consistent with the broad language of the statute and Rule, the Supreme Court has repeatedly emphasized the broad anti-fraud purposes of the federal securities laws, even as recently as one week

² Liability under subsection (a) of Rule 10b-5 is referred to herein generally as "scheme" liability; liability under subsection (b) of Rule 10b-5 is referred to herein generally as "misrepresentation or omission" liability; and liability under subsection (c) of Rule 10b-5 is referred to herein generally as "course of business" liability. Notwithstanding these general references, liability under Rule 10b-5 may be premised on any of the eight acts listed in the text.

ago. *See, e.g., SEC v. Zandford*, No. 01-147, 2002 U.S. LEXIS 4023, at *11-*16 (June 3, 2002) (emphasizing broad language and interpretation of anti-fraud provisions and citing cases); *United States v. O'Hagan*, 521 U.S. 642, 658 (1997) (Congress intended "to insure honest securities markets and thereby promote investor confidence"); *Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977) ("No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."); *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972) (proscriptions of § 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry'" (quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)); *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 11 n.7 (1971) ("'[We do not] think it sound to dismiss a complaint merely because the alleged scheme does not involve the type of fraud that is 'usually associated with the sale or purchase of securities.' We believe that § 10 (b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws.'" (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)); *Capital Gains Research*, 375 U.S. at 195 (§ 10(b) should be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes"). Needless to say, nothing in *Central Bank* indicates that the Court suddenly has adopted a different view.

The Defendants' interpretation of *Central Bank* would result in virtual immunity for banks,

law firms, accountants, and other securities professionals from private liability in many cases. The view that those crafty enough to benefit from participating in a securities fraud while carefully avoiding the public attribution of a false statement to them can escape liability directly conflicts with both the broad language and purposes of the anti-fraud provisions. Indeed, one could argue that it is precisely with respect to such schemes that the anti-fraud provisions are needed the most.

The Supreme Court expressly said that “[a]ny person or entity including a lawyer, accountant or bank,...may be liable as a primary violator under 10b-5.” 511 U.S. at 191. (emphasis added). “The absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts.” *Id.* Even more to the point, while the *Central Bank* decision did sweep away decades of precedent upholding aiding and abetting liability, it did not strike down any language in Section 10(b) or Rule 10b-5 or sweep away the extremely broad antifraud purposes of the federal securities laws.

All *Central Bank* stands for is the proposition that, to be held liable, a defendant must commit one or more of the eight types of manipulative or deceptive devices or contrivances specified in Rule 10b-5 itself rather than merely assist another to do so. But the Defendants fail to grasp the fundamental point that *Central Bank* did not change the types of conduct that constitute manipulative or deceptive devices or contrivances. In other words, *Central Bank* concerned the relationship or connection between the defendant and the fraudulent conduct; it did not alter the definition of the fraudulent conduct itself. *See* 511 U.S. at 167 (question before Court was “whether private civil liability under § 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation”); *see also id.* at 184 (“Aiding and abetting is ‘a method by which courts create secondary liability’ in persons other than the violator of the statute.”). *Central*

Bank, therefore, is about degree, not kind.

Thus, the central question that this court must answer with respect to each Defendant's motion to dismiss is: Does the Consolidated Complaint sufficiently allege that the Defendant, acting alone or jointly with others, engaged in any of the manipulative or deceptive devices or contrivances specified in subsections (a), (b), or (c) of Rule 10b-5? None of the bank, law firm, or accountant Defendants is alleged to be a mere aider and abettor. None are alleged to have merely lent aid to another in committing manipulative or deceptive acts. Each is alleged to have committed its own manipulative or deceptive devices or contrivances by the means specified in Rule 10b-5, which, if proved, should establish their liability. *Central Bank* at 191

B. The Banks, Law Firms, and Accountants Are Subject to Liability for Their Significant Roles in the Preparation of Misrepresentations and Omissions

With respect to misrepresentation or omission liability falling within subsection (b) of Rule 10b-5, the courts have taken two main approaches to liability in the wake of *Central Bank*. Under the "substantial participation" approach followed by the Ninth Circuit, this court, the Eastern District of Texas, the Northern District of Illinois, and the Southern District of Ohio, to establish primary liability for a "secondary actor," it must be shown that: (1) the defendant either made a misrepresentation or omission or "substantially participated" in the preparation of a misrepresentation made by someone else; and (2) the defendant knew or should have known that the misrepresentation or omission would be relied upon by investors, but public attribution of the secondary actor's role is unnecessary.³ Under the "bright line" approach followed by the Second, Tenth, and Eleventh

³ See *In re Software Toolworks Sec. Litig.*, 50 F.3d 615, 628 & n.3 (9th Cir. 1995); *McGinn v. Ernst & Young*, 102 F.3d 390, 397 (9th Cir. 1996); *Cooper v. Pickett*, 137 F.3d 616, 624-29 (9th Cir. 1998); *Howard v. Everex Sys.*, 228 F.3d 1057, 1061 (9th Cir. 2000); *Young v. Nationwide Life Ins. Co.*, 2 F. Supp. 2d 914, 921 (S.D. Tex. 1998); *McNamara v. Bre-X Minerals Ltd.*, No. 5:97-CV-

Circuits, the Eastern District of Pennsylvania, the District Court of Massachusetts, and the Northern District of Texas, to establish primary liability for a "secondary actor," it must be shown that: (1) the defendant itself actually made a materially false or misleading statement (or omitted a material fact while under a duty to disclose); (2) the defendant knew or should have known that the misrepresentation or omission would be relied upon by investors; and, at least with respect to a few courts, (3) the misstatement was attributed to the defendant at the time of its dissemination.⁴

The Defendants fail to recognize that neither test requires that the alleged violator actually directly communicate misrepresentations to the plaintiffs for primary liability to attach. See *ZZZZ Best*, 864 F. Supp. at 964-72 (employing "substantial participation" approach) ("liability under Section 10(b)/Rule 10b-5 is not limited to the making of materially false and misleading statements or omissions"); *Wright*, 152 F.3d at 171-76 (employing "bright line" approach) ("There is no requirement that the alleged violator directly communicate misrepresentations to plaintiffs for primary liability to attach.") (quoting *Anixter*, 77 F.3d at 1225-27 (same)). Rather, it is necessary only that

159, 2001 U.S. Dist. LEXIS 4571, at *131 (E.D. Tex. Mar. 30, 2001); *In re Dublin Sec.*, 197 B.R. 66, 66-73 (S.D. Ohio 1996), *aff'd*, 133 F.3d 377 (6th Cir. 1997); *Flecker v. Hollywood Entm't Corp.*, No. 95-1926, 1997 U.S. Dist. LEXIS 5329 (D. Or. Feb. 12, 1997); *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 429-33 (N.D. Ill. 1995); *Adam v. Silicon Valley Bancshares*, 884 F. Supp. 1398, 1398-1402 (N.D. Cal. 1995); *In re ZZZZ Best Sec. Litig.*, 864 F. Supp. 960, 964-72 (C.D. Cal. 1994); *Employers Ins. v. Musick, Peeler, & Garrett*, 871 F. Supp. 381, 388-89 (S.D. Cal. 1994).

⁴ See *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205-12 (11th Cir. 2001); *Wright v. Ernst & Young LLP*, 152 F.3d 169, 171-76 (2d Cir. 1998); *Shapiro v. Cantor*, 123 F.3d 717, 720-22 (2d Cir. 1997); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1225-27 (10th Cir. 1996); *Lemmer v. Nu-Kote Holding, Inc.*, No. 3:98-CV-01610-L, 2001 U.S. Dist. LEXIS 13978, *25-*28 (N.D. Tex. Sept. 6, 2001); *Winkler v. NRD Mining, Ltd.*, 198 F.R.D. 355, 364 (E.D.N.Y.), *aff'd sub nom.*, *Winkler v. Wigley*, 242 F.3d 369 (2d Cir. 2000); *In re JWP Inc. Sec. Litig.*, 928 F. Supp. 1239, 1256 (S.D.N.Y. 1996); *Phillips v. Kidder, Peabody & Co.*, 933 F. Supp. 303, 324 (S.D.N.Y. 1996), *aff'd without op.*, 108 F.3d 1370 (2d Cir. 1997); *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371, 1378 (E.D. Pa. 1994); *In re Kendall Square Research Corp. Sec. Litig.*, 868 F. Supp. 26, 26-28 (D. Mass. 1994).

the defendant knew or should have known that its misrepresentation or omission would be relied upon by investors. See *McCann*, 102 F.3d at 397 (employing “substantial participation” approach); *McNamara*, 2001 U.S. Dist. LEXIS 4571, at *131 (employing “substantial participation” approach); *Wright*, 152 F.3d at 171-76 (employing “bright line” approach); *Anixter*, 77 F.3d at 1225-27 (employing “bright line” approach). There is no requirement that the alleged violator actually directly communicate misrepresentations to plaintiffs for primary liability to attach. Therefore, some significant role in the preparation or creation of a misstatement that is directly communicated to investors by another party can suffice for primary liability under either post-*Central Bank* test.

A few “bright line” courts hold that, whether the defendant’s statement is communicated directly to investors or indirectly through others, the defendant’s statement must be attributed to the defendant by name to be actionable. See *Ziembra*, 256 F.3d at 1205-12; *Wright*, 152 F.3d at 171-76; *Winkler*, 198 F.R.D. at 364. There is no valid basis for this requirement. Courts that have adopted the attribution requirement have done so on the mistaken assumption that imposing liability on a defendant when the investors did not know of the defendant’s involvement in the misrepresentation negates the requisite element of reliance. But that reasoning is flawed. Plaintiffs certainly can rely on a statement without knowing exactly who made it. Reliance can exist without the statement being signed by the defendant or otherwise identified to the defendant by name.

Moreover, nothing in *Central Bank* mandates the conclusion that the concept of “making an untrue statement” is limited to signing such a statement or having such a statement identify its speaker by name. In fact, the Supreme Court recognized in *Central Bank* that liability requires reliance on a misrepresentation, not on a misrepresentation that is identified as the statement of a particular person: “Any person or entity, including a lawyer, accountant, or bank, who . . . makes a material

misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met.” 511 U.S. at 191 (emphasis added). Moreover, if the word “indirectly” in §10(b) and Rule 10b-5 means anything at all, it certainly should cover the situation where a defendant creates a misrepresentation but carefully avoids being publicly identified with it. Fraudulent misrepresentations should not be immune from liability so long as their creator is concealed. Otherwise, every “secondary actor” would easily be able to avoid liability simply by conditioning its services on remaining anonymous in any public statements. For these reasons, although reliance is necessary, attribution is not

C. The Banks, Law Firms, and Accountants Are Subject to Liability for Employing a Device, Scheme, or Artifice to Defraud and for Engaging in an Act, Practice, or Course of Business That Operated as a Fraud or Deceit

In addition to the allegations that Defendants have made misrepresentations or omissions subject to liability under subsection (b) of Rule 10b-5, the Consolidated Complaint alleges that they have employed devices, schemes, or artifices to defraud and engaged in acts, practices, or courses of business that operated as a fraud or deceit that subject them to liability under subsections (a) and (c) of Rule 10b-5. The Supreme Court just one week ago reconfirmed what the Court and the federal circuit courts of appeals have long recognized -- that the scope of liability under subsections (a) and (c) of Rule 10b-5 is broader than that under subsection (b) and that those who engage in a fraudulent scheme may be held liable in the absence of misrepresentations or omissions. *See, e.g., Zandford*, 2002 U.S. LEXIS 4023, at *11-*18 (broker held liable for fraudulent scheme and course of business under subsections (a) and (c) of Rule 10b-5 in absence of misrepresentation; “neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security

in order to run afoul of the Act"); *Affiliated Ute Citizens*, 406 U.S. at 152-53 (subsections (a) and (c) are broader than subsection (b) of Rule 10b-5); *SEC v. First Jersey Sec.*, 101 F.3d 1450, 1471-72 (2d Cir. 1996); *SEC v. Seaboard*, 677 F.2d 1301, 1312 (9th Cir. 1982); *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981) (*en banc*); *Competitive Assocs., Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 814-15 (2d Cir. 1975) ("Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'nondisclosures'. Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws."), *Blackie v. Barrack*, 524 F.2d 891, 903 n.19 (9th Cir. 1975) ("Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; it may also be predicated on a 'practice, or course of business which operates . . . as a fraud'"); *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) ("Rule 10b-5 is a remedial measure of far greater breadth than merely prohibiting misrepresentations and nondisclosures concerning stock prices. No attempt is made in 10b-5 to specify what forms of deception are prohibited; rather, all fraudulent schemes in connection with the purchase and sale of securities are prohibited.") (footnote omitted).⁵

Although it is not clear from their motions, the banks, law firms, and accountants apparently ignore "scheme" and "course of business" liability based on the erroneous assumption that the Supreme Court in *Central Bank* impliedly struck down subsections (a) and (c) and overruled its prior

⁵ The federal district courts also have adopted this view. See, e.g., *Wenneman v. Brown*, 49 F. Supp. 2d 1283 (D. Utah 1999); *Adam*, 884 F. Supp. at 1400; *ZZZZ Best*, 864 F. Supp. at 971-72; *Hill v. Hanover Energy, Inc.*, No. 91-1964 (JHG), 1991 U.S. Dist. LEXIS 18566 (D.D.C. Dec. 16, 1991); *In re Union Carbide Corp. Consumer Prods. Bus. Sec. Litig.*, 676 F. Supp. 458, 467-70 (S.D.N.Y. 1987) (Morgan Stanley's liability does not depend on whether it "certified or made other public representations about a corporation's allegedly misleading statements", its "alleged role in knowingly or recklessly preparing the projections could constitute the employment of a 'device, scheme, or artifice to defraud' in violation of 10b-5(1) or an 'act, practice, or course of business which operates or would operate as a fraud or deceit upon any person' in violation of 10b-5(3).").

opinions approving of those subsections when it summarized § 10(b) liability by stating that “the statute prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act.” *Central Bank*, 511 U.S. at 177.⁶

As noted above, the *Zandford* decision reconfirms that *Central Bank* did nothing to disturb liability under subsections (a) or (c) of Rule 10b-5. In *Zandford*, the Supreme Court explicitly approved of “scheme” and “course of business” liability under those subsections. See 2002 U.S. LEXIS 4023, at *7-*22.⁷ In upholding “scheme” and “course of business” liability in *Zandford*, the Supreme Court explicitly approved all subsections of Rule 10b-5: “The scope of Rule 10b-5 is coextensive with the coverage of § 10(b).” *Id.* at *7 n.1 (emphasis added); see also *id.* at *11 (Rule 10b-5 “implements” Section 10(b)).⁸

⁶ Some of the Defendants also claim that “manipulation” is an extremely limited concept under Section 10(b), relying on dicta in a few cases that states that “manipulation” is a “term of art” including wash sales, matched orders, and rigged prices designed to mislead investors by affecting the market price of securities. See *Santa Fe Indus.*, 430 U.S. at 476 (deciding case on deception grounds); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199, 212 (1976) (deciding case on scienter grounds); *Superintendent of Ins.*, 404 U.S. at 11 (deciding case on standing grounds).

⁷ *O’Hagan*, another post-*Central Bank* case, also reaffirmed that a statement is not required for Section 10(b) liability. See 521 U.S. at 653, 658-59 (upholding misappropriation theory of insider trading, finding such conduct a “deceptive device or contrivance”). In *O’Hagan*, the Court emphasized once again that “the statute reaches any deceptive device used ‘in connection with the purchase or sale of any security.’” *Id.* at 651. The Court observed that misappropriators “deal in deception.” *Id.* at 653. Of particular note is that the Court discussed *Central Bank* only with respect to a peripheral point in the lower court’s decision and that the dissenting opinions of Justices Scalia and Thomas did not even discuss *Central Bank* at all.

⁸ The Supreme Court also had recognized the validity of scheme liability even before *Zandford*. In *Hochfelder*, the Supreme Court implicitly found that a “scheme to defraud” falls within the meaning of the “manipulative or deceptive device or contrivance” language of § 10(b). 425 U.S. at 199 n.20. In considering whether negligence sufficed for liability under § 10(b), the Court relied in part on the 1934 dictionary definitions of “device” and “contrivance.” See *id.*, see also *Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980) (relying on same definitions to find scienter requirement under § 17(a)(1) of 1933 Act). Both of those definitions included a “scheme.” See *Hochfelder*, 425 U.S.

As discussed above, the point the Court was making in *Central Bank* was only that mere aiding and abetting, as opposed to primary manipulative or deceptive acts, is insufficient for liability. The short-hand reference to the most common type of § 10(b) liability was sufficient for that point, without it being necessary to restate the entire language of the statute and Rule 10b-5. The Court was not making a comprehensive, all-inclusive statement of the entire scope of fraud liability under the statute and Rule. The reason for that is simple: it was not at issue.

In *Central Bank*, the plaintiffs did not allege primary liability against the bank, did not allege that the bank participated in a scheme to defraud, did not allege that the bank engaged in a fraudulent practice or course of business, and did not invoke subsections (a) or (c) of Rule 10b-5 against the bank. The plaintiffs alleged *solely* that the bank was “‘secondarily liable under § 10(b) for its conduct in aiding and abetting the fraud.’” 511 U.S. at 168 (emphasis added). Accordingly, the Supreme Court *solely* addressed “whether private civil liability under § 10(b) extends as well to those who do not engage in the manipulative or deceptive practice, but who aid and abet the violation.” *Id.* at 166; *see also id.* at 184 (“Aiding and abetting is ‘a method by which courts create secondary liability’ in persons other than the violator of the statute.”) (citation omitted). The Court, therefore, was not presented with and did not address the bases for liability specified in subsections (a) or (c) of Rule 10b-5. *See Adam*, 884 F. Supp. at 1400 (noting that *Central Bank* did not address liability theories other than aiding and abetting).

Moreover, there is absolutely nothing in the language of the statute, the Rule, or the legislative history that warrants restricting liability solely to misrepresentations or omissions or certain technical forms of manipulation. The express language of § 10(b) allows for liability by a person who does not

at 199 n.20.

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actually make a statement or omit to say something he is under a duty to disclose. The statutory language “directly or indirectly, . . . [t]o use or employ” in Section 10(b) is much broader than simply “directly to make,” which is how the Defendants would interpret the statute. Similarly, the statutory language “any manipulative or deceptive device or contrivance” is much broader than simply “a misrepresentation or omission,” which is how the Defendants would interpret the statute. Therefore, if the starting point in interpreting a statute is the language itself, *see Central Bank*, 511 U.S. at 173, there is no reason why liability under Section 10(b) must be limited to directly making misstatements or omissions or manipulating securities prices through certain specific technical or mechanical means.⁹

The broad purposes of § 10(b)’s prohibition of securities fraud and the Supreme Court’s longstanding recognition of such broad purposes also support scheme liability. *See, e.g., Zandford*, 2002 U.S. LEXIS 4023, at *11-*12; *Santa Fe Indus.*, 430 U.S. at 477; *Affiliated Ute Citizens*, 406 U.S. at 152-53 (quoting *Capital Gains Research*, 375 U.S. at 186); *Superintendent of Ins.*, 404 U.S. at 11 n.7 (quoting *A.T. Brod & Co.*, 375 F.2d at 397); *Capital Gains Research*, 375 U.S. at 186.

The banks, law firms, and accountants also may misinterpret scheme and course of business liability on the closely-related erroneous assumption, again premised on *Central Bank*, that such bases of liability are impermissible secondary forms of liability. They are not. All three subsections of Rule 10b-5 proscribe conduct for which a defendant may be primarily liable. There is nothing derivative,

⁹ As the Supreme Court has stated, “no doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices.” *Santa Fe Indus.*, 430 U.S. at 477. The statute itself contains only the very general “manipulative or deceptive devices or contrivances” language, while leaving it to the SEC to more specifically describe fraudulent conduct. The SEC’s rulemaking authority would be superfluous if the rules it adopted had to use precisely the same words as in the statute. It was patently reasonable for the SEC to have determined that the “employment” of a “scheme to defraud” and the “engagement” in a fraudulent “act, practice, or course of business” constitute conduct falling within the statutory prohibition of the “use or employ[ment]” of a “manipulative or deceptive device or contrivance.”

vicarious, or secondary about such liability. Therefore, liability for a scheme to defraud or fraudulent act, practice, or course of business does not run afoul of *Central Bank*'s elimination of aiding and abetting liability. See generally *Central Bank*, 511 U.S. at 191 ("In any complex securities fraud . . . there are likely to be multiple violators.").

Cases both before and after *Central Bank* have recognized that scheme liability is a form of primary liability. *Cooper v. Pickett*, 137 F.3d 616, 624 (9th Cir. 1998) (*Central Bank* "does not preclude liability based on allegations that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme."); *First Jersey*, 101 F.3d at 1471-72; *Adam*, 884 F. Supp. at 1399-1401; *ZZZZ Best*, 864 F. Supp. at 971-72 ("It appears that the scope of deceptive devices or schemes prohibited by subsections (a) and (c) [of Rule 10b-5] is quite extensive."); *Mill*, 1991 U.S. Dist. LEXIS 18566, at *10-*12.

In *ZZZZ Best*, the plaintiffs alleged that Ernst & Young, hired to review the company's financial statements, was primarily liable because it participated in the creation of publicly released statements, issued a review report, and failed to disclose additional material facts unrelated to the review report. Ernst & Young moved for dismissal on the same grounds that the Defendants are asserting in the present action, that it was really being charged with aiding and abetting liability precluded by *Central Bank*. The court denied the motion, concluding that the facts taken as a whole as to Ernst & Young's participation and knowledge could render it liable under a scheme to defraud. See 864 F. Supp. at 969-72.

In *Adam*, the plaintiffs alleged that Deloitte & Touche was primarily liable under § 10(b) for misrepresentations and "participation in a scheme to defraud" through its involvement with the

issuer's press releases and financial statements 884 F. Supp. at 1401. The plaintiffs also alleged that Deloitte knew of the inadequate controls and deviated from conducting its audits in accordance with generally accepted auditing standards. *Id.* at 1399. The court denied the accounting firm's motion to dismiss because it found that its participation in the preparation of the issuer's statements was part of a scheme to defraud, making the firm primarily liable under Rule 10b-5. *Id.* at 1399-1401. In so holding, the court recognized that Rule 10b-5(b) "essentially outlaws the making of a material misrepresentation or omission," but that subsections (a) and (c) of the Rule "also" outlaw fraudulent schemes and courses of conduct. *Id.* at 1400.

D. The Banks, Law Firms, and Accountants Are Subject to Liability for Each Other's Conduct Taken in Furtherance of the Scheme to Defraud in Which They Participated

The bank, law firm, and accountant Defendants argue that they are not responsible for the fraudulent acts of others or for conduct that occurred prior to their involvement. To the contrary, however, they are liable for any of the unlawful acts taken by any of the participants in the scheme to defraud in which they participated.

A defendant who participates in a scheme to defraud is liable for the damages caused by all of the acts taken by the participants in the scheme in furtherance of the fraud. *See Software Toolworks*, 50 F.3d at 627-29 & n.3 (participants in scheme to defraud can be liable for statements made by others in the scheme); *Adam*, 884 F. Supp. at 1401 (same); *ZZZZ Best*, 864 F. Supp. at 968-72 (same).¹⁰ This is because a scheme to defraud is a unitary violation, such that the plaintiff need

¹⁰ Similarly, under the federal mail fraud statute, 18 U.S.C. § 1341, participants in a scheme to defraud are liable for the acts of the other participants in the scheme, even if the others committed the key acts. *See, e.g., United States v. Humphrey*, 104 F.3d 65, 70 (5th Cir. 1997); *United States v. Lothian*, 976 F.2d 1257 (9th Cir. 1992); *United States v. Maxwell*, 920 F.2d 1028, 1035 (D.C. Cir. 1990); *United States v. Lanier*, 838 F.2d 281, 284 (8th Cir. 1988); *United States v. Wiehoff*, 748 F.2d

not prove transaction causation with respect to any particular misrepresentations or omissions or other components of the scheme. See *Shores*, 647 F.2d at 469, 472 ("The concept of [a] scheme to defraud satisfies the requirement of 'transaction causation.' It has as its core objective that the potential victim engage in the transaction for which the scheme was conceived.") (footnote and citation omitted); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380-81 (2d Cir. 1974); *ZZZZ Best*, 864 F. Supp. at 973 (to satisfy reliance requirement for scheme liability, it need only be shown that market relied on overall fraudulent scheme rather than on individual statements or omissions).¹¹

1158, 1161 (7th Cir. 1984); *United States v. Craig*, 573 F.2d 455, 483-84 (7th Cir. 1977).

The common law also recognized this principle, with respect to contributing tortfeasors or persons acting in concert. See *Restatement 2d, Torts*, § 875 (1979) ("Each of two or more persons whose tortious conduct is a legal cause of a single and indivisible harm to the injured party is subject to liability to the injured party for the entire harm."); *id.* at § 876(a) ("For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with him. . . ."); *id.* at § 876(a), Comment on Clause (a) ("Whenever two or more persons commit tortious acts in concert, each becomes subject to liability for the acts of the others, as well as for his own acts.").

¹¹ In addition, it is axiomatic with respect to any scheme liability that a defendant may be held liable for participating in a scheme even if it did not interact with all the other participants, was unaware of the identity of each of the other participants, did not know about the specific roles of the other participants in the scheme, did not know about or participate in all of the details of each aspect of the scheme, or joined the scheme at a different time than the other participants. See *Craig*, 573 F.2d at 483-84 (scheme to defraud under mail fraud statute); *United States v. Elam*, 678 F.2d 1234, 1246 (5th Cir. 1982) (conspiracy); *United States v. Alvarez*, 625 F.2d 1196, 1198 (5th Cir. 1980) (*en banc*) (conspiracy). As the Supreme Court has stated with respect to conspiracy liability: "[T]he law rightly gives room for allowing the conviction of those discovered [to be participants in a conspiracy] upon showing sufficiently the essential nature of the plan and their connections with it, without requiring evidence of knowledge of all its details or of the participation of others. Otherwise . . . conspirators would go free by their very ingenuity." *Blumenthal v. United States*, 332 U.S. 539, 557 (1947) (footnote omitted). If knowledge of all the other details, activities, and participants in a scheme is not essential for conspiracy liability, which requires an agreement among the participants, then such knowledge certainly is not necessary for scheme liability, which does not require an agreement. See *United States v. Read*, 658 F.2d 1225, 1239-40 (7th Cir. 1981).

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III. CONCLUSION

Central Bank did not eliminate liability for accountants, lawyers or banks where their alleged conduct makes them primarily liable under Rule 10b-5. Plaintiffs' allegations are sufficient to permit further development of the facts in this landmark securities fraud action ¹²

Respectfully submitted,

FOR THE STATE OF TEXAS

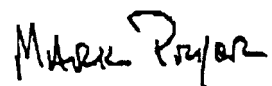
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Jeffrey S. Boyd
Deputy Attorney General for Litigation
(Attorney in Charge)
Texas Bar No. 02772150
P.O. Box 12548
Austin, TX 78711-2548
Telephone: (512) 936-1886
Facsimile: (512) 463-0263
E-mail: jeff.boyd@oag.state.tx.us

¹² The same analysis should be applicable to the officers and directors who are named Defendants. *See supra* n.1.

FOR THE STATE OF ARKANSAS:

A handwritten signature in black ink, appearing to read "Mark Pryor". The signature is written in a cursive, slightly slanted style.

By: MARK PRYOR

ATTORNEY GENERAL

FOR THE STATE OF CALIFORNIA:
BILL LOCKYER
Attorney General

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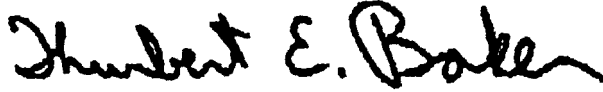
By: MANUEL M. MEDEIROS
State Solicitor General

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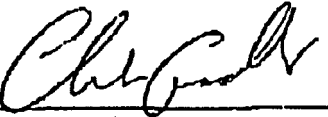
FOR THE STATE OF GEORGIA:

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By: The Honorable Thurbert E. Baker
ATTORNEY GENERAL

FOR THE STATE OF ILLINOIS

JIM RYAN
ATTORNEY GENERAL

BY: 
Charles Godbey
Assistant Attorney General

JUN-10-2002 09:28

III. CONCLUSION

Central Bank did not eliminate liability for accountants, lawyers or banks where their alleged conduct makes them primarily liable under Rule 10b-5. Plaintiffs' allegations are sufficient to permit further development of the facts in this landmark securities fraud action.¹²

Respectfully submitted,

RICHARD P. IEYOUB
Attorney General
State of Louisiana

Dated: June 10, 2002

BY: 

DENNIS C. WEBER
First Assistant Attorney General

N:\CASES\Enron\AGAmicus.brf


¹² The same analysis should be applicable to the officers and directors who are named Defendants.
See supra n.1.

In re ENRON CORPORATION
SECURITIES LITIGATION

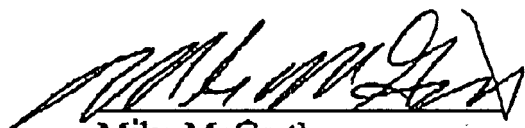
C.A. No. H-U1-3624 (Consolidated)

Amicus Curiae Memorandum Relating To
Motions to Dismiss Filed by the Attorneys General

COMMONWEALTH OF MASSACHUSETTS



THOMAS F. REILLY
ATTORNEY GENERAL



Mike McGrath
Montana Attorney General
P.O. Box 201401
Helena, MT 59620-1401
Tel: (406) 444-2026

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FOR THE STATE OF NEBRASKA

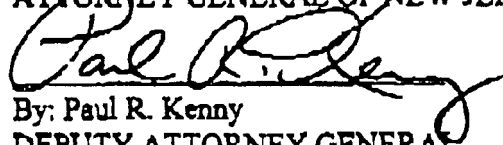
By: (typed name) Don Stenberg

ATTORNEY GENERAL

FOR THE STATE OF NEW JERSEY:

DAVID SAMSON

ATTORNEY GENERAL OF NEW JERSEY

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By: Paul R. Kenny

DEPUTY ATTORNEY GENERAL

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES
LITIGATION

Civil Action No. H-01-3624
(Consolidated)

This Document Relates To:

CLASS ACTION

MARK NEWBY, et al., Individually and On
Behalf of All Others Similarly Situated,

Plaintiffs,

vs.

AMICUS CURIAE MEMORANDUM
RELATING TO DEFENDANTS'
MOTIONS TO DISMISS FILED BY THE
ATTORNEYS GENERAL OF []

ENRON CORP., et al.,

Defendants.

THE REGENTS OF THE UNIVERSITY OF
CALIFORNIA, et al., Individually and On
Behalf of All Others Similarly Situated,

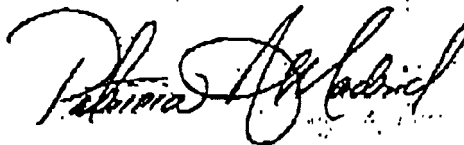
Plaintiffs,

vs.

KENNETH L. LAY, et al.,

Defendants.

FOR THE STATE OF NEW MEXICO

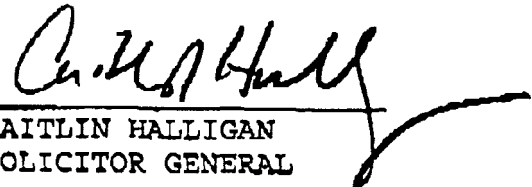


June 10, 2002
DATE

PATRICIA A. MADRID
ATTORNEY GENERAL

FOR THE STATE OF NEW YORK:

ELIOT SPITZER
ATTORNEY GENERAL

By: 
CAITLIN HALLIGAN
SOLICITOR GENERAL

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FOR THE STATE OF Ohio:

By: (typed name)

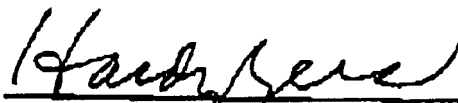
ATTORNEY GENERAL

David M. Gormley
State Solicitor

for

Betty D. Montgomery
Attorney General of Ohio

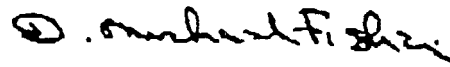
STATE OF OREGON

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HARDY MYERS

Attorney General
Department of Justice
1162 Court Street N.E.
Salem, Oregon 97301

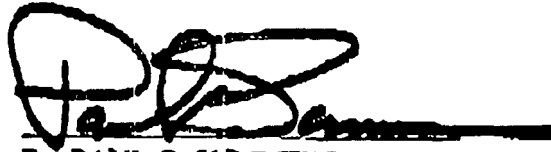
FOR THE COMMONWEALTH OF PENNSYLVANIA:



By: D. MICHAEL FISHER

ATTORNEY GENERAL


FOR THE STATE OF TENNESSEE:

A handwritten signature in black ink, appearing to be 'P. G. Summers', written over a horizontal line.

By: PAUL G. SUMMERS

ATTORNEY GENERAL

FOR THE STATE OF WASHINGTON:


By: Christine O. Gregoire

ATTORNEY GENERAL